



Should the Voucher Privatization Scheme Be Extended?

Summary

The validity of privatization vouchers expires on December 31, 2003 in compliance with government regulations. Now the question arises for decision makers: Should the voucher privatization be extended or what else should be done? There are four main possibilities of how to deal with this question: 1) continuation of the current voucher privatization scheme; 2) termination of voucher privatization with cash compensation for unused vouchers; 3) continuation of voucher privatization, but with the creation of new investment funds and 4) termination of the voucher privatization scheme without cash compensation.

The first scenario implies that most of them enterprises might not be able to find strategic investors and might not be able to increase their efficiency. The government would not receive additional privatization revenues; moreover, it might have to increase its expenditures in order to support the remaining state-owned enterprises. Individuals would not be able to sell the shares they had obtained for their vouchers. Cash compensation for the voucher holders (scenario 2) would end the inefficient voucher privatization process. But the fiscal burden of around USD 400 m needed for cash compensation would lead to a harmful macroeconomic destabilization. The third scenario, i.e., the creation of new investment funds, which would exchange their own shares for vouchers, looks better than the previous two since enterprises would get a chance to begin restructuring and search for investors, while the voucher holders could exchange their vouchers for shares. However, it is unlikely that such new investment funds would work properly. Ending the voucher privatization scheme without any compensation (scenario 4) is in our view the best scenario. It would contribute to economic reform in Belarus and improve the efficiency and international competitiveness of Belarusian enterprises. Moreover, it would not lead to a macroeconomic destabilization.

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1. Introduction

The law "on Privatization of State Property in Belarus" requires that half of the state property in Belarus must be privatized by means of vouchers. The law "on Personal Privatization Checks (Vouchers)" guarantees the possibility of monetary compensation to all the owners who for various reasons did not use their vouchers.

The Council of Ministries proposes to finish the voucher privatization scheme on December 31, 2003. Parliament however, insists on prolongation, or as an option, on offering monetary compensation for any unused vouchers. The arguments of both sides are clear and reasonable. On one hand, the opportunities for people to use the vouchers were very limited, since there were not very many enterprises subject to privatization. On the other hand, many people refused to invest their vouchers in those enterprises, which are available (in 2003, there were over 200 enterprises listed, representing different branches of industry, but most of them were unprofitable). So far, only slightly more than half of all vouchers have been used. Despite the low nominal value of a voucher, there is no money in the state coffers to compensate all voucher owners. Assuming a voucher price is BYR 3600, the total cost of compensation will amount to USD 400 m or 12% of the total annual budget. Thus, Parliament and the Council of Ministries need to make a decision with serious economic and political implications.

2. The voucher privatization in Belarus

2.1. The international experience with voucher privatization

Privatization is one of the main and complicated reforms in the process of creating a market economy in post-socialist countries. Its successful implementation is of crucial importance for the transition economies. Creating a stock market, increasing the operational efficiency of enterprises, and restructuring the economy by orienting the enterprises towards the demand-and-supply approach are considered to be some of the key goals of privatization along with many others.

The voucher privatization approach has advantages and disadvantages. Among the advantages are its fast pace, low political risks (social justice), and the quick creation of a stock market. Yet it also has many disadvantages, too. The main ones are uncertain property rights, lack of real investments, and inadequate management teams, which are not interested in the long-term development of their enterprises.

Yet, as the experience of voucher privatization in the Czech Republic, Poland, and in Russia has shown, it is better to have had a voucher privatization scheme than no privatization at all. Over the short term the voucher privatization system has some disadvantages, especially when legal restrictions for obtaining a controlling block of shares apply, where there are low listing requirements, etc. But over the long term it allows to start the restructuring of enterprises and to create an appropriate property rights portfolio, which would help to build strong and competitive enterprises. For instance, the Russian privatization in general, which was strongly criticized in the mid 1990s, helped enterprises in the food, light, woodworking and building materials industries to attract domestic and foreign investments and considerably raise their levels of competitiveness.

2.2. The evolution of voucher privatization in Belarus

In 1993, the process of privatization began in earnest, after adoption of the laws "on Privatization of State Property in Belarus" and "on Personal Privatization Checks (Vouchers)". Belarus, similar to many other transition countries, chose the mass privatization model. Personal privatization checks (vouchers "Imushchestvo") were promoted as an alternate vehicle for acquisition of state property, two thirds of which was supposed to be privatized, half thereof using vouchers. In addition, any employee of a state enterprise was supposed to have special rights for obtaining shares in the enterprise.

Thus 7.8 million Belarusian citizens had the right to obtain personal vouchers, while only about 4.9 million virtually received 427.6 million vouchers. According to Article 13 of the law "on Personal Privatization Checks (Vouchers)" "... upon completion of the term of voucher privatization, owners of unused vouchers can return them to the National Bank or to the local authori-

ties. The state guarantees each owner (citizen of the Republic of Belarus) compensation for all vouchers they own at the voucher price that prevailed at the end of voucher privatization."

Between 1998 and 2003 the dynamics of privatization process in Belarus was considerably decreased compare to 1995-1996. Only the least profitable and least financially attractive enterprises were privatized, most of which do not pay any dividends at present. As a result:

- The professional participants in the voucher market – specialized investment funds (SIFs) – are inactive;
- Firms and enterprises are not allowed to sell vouchers, and SIFs are allowed to invest in vouchers in privatization objects only at voucher auctions on the stock exchange in accordance with a quota;
- The SIF shares acquired for vouchers or for shares at preferential terms are not allowed to be sold¹;
- The state is the main owner of the issued shares;
- A stock market has not yet been founded in Belarus.

On December 24, 2002 the Presidium of the Council of Ministers approved adjustments to the law "on Personal Privatization Checks in Belarus." The new draft law envisages the abolition of monetary compensation for vouchers once the term of their circulation has expired. According to the draft law, the free-of-charge voucher privatization scheme terminates on December 31, 2003. The Council of Ministries' proposal was rejected during parliamentary hearings on June 26, 2003 "on the Status of Privatization in the Country." The executive was asked to propose other options for using the vouchers after December 31, 2003 or to find ways to provide monetary compensation.

One of the Council of Ministries' main arguments we could find the point that since the very beginning of the voucher privatization scheme in Belarus, the process of exchanging vouchers for shares has been getting slower and slower (most of the vouchers had been exchanged by 1999). The government emphasizes that voucher privatization simply implies that people participate in the privatization process and that this opportunity has being provided for all years since 1994. By April 1, 2003 voucher owners had the opportunity to exchange vouchers for shares of 221 enterprises (corporations), which include privatized enterprises in the light industry, the food industry, engineering etc. Monetary compensation requires money, which means an additional fiscal burden for enterprises and the population at large. And what is very important at present is that the enterprises badly need investment into technologies and equipment. This presupposes a search for strategic investors and the sale of enterprises for money.

On the other hand, the members of Parliament insist that during the period of voucher privatization in Belarus people had limited possibilities to use the vouchers due to the slow pace of privatization. The most attractive enterprises from the point of view of dividends (i.e., the oil processing companies) are being privatized for money in accordance with a presidential decree. According to the government regulations only employees of, in some extent attractive, privatized enterprises has the right to exchange their vouchers for shares. Moreover, their main argument is that the law guarantees a monetary compensation for unused vouchers.

3. The interests of the three involved groups

There are three groups of players in the voucher privatization process. Each group has its own interests, which to some extent are in conflict with those of the others.

Enterprises (both management and employees) strive to be profitable and competitive. This is a consequence of increased enterprise efficiency. In order to achieve greater efficiencies pri-

¹ The authorities did not want people to sell their shares to outside investors (for fear that all property would be purchased by foreigners). To this end, the President passed a decree to ban trading of any shares acquired at preferential prices by employees of privatized enterprises, or acquired for vouchers at the Sberbank departments (Presidential Decree №3 and amendments to the Law "on Privatization ..." in 1999). 10% of the total number of shares is now disallowed from sale or from being acquired, most of all others belong to the state.

vatized enterprises have to improve their technology, purchase modern equipment, train staff in working in the new market environment, fire unnecessary staff, etc. This process requires money and is made possible only by new investors eager to invest in order to make profit. In this case the investors get the right to control the enterprise.

The possibility of buying an enterprise with vouchers implies restrictions in searching for and attracting new investment. The state, as a main stakeholder, restricts the restructuring processes even more, both at the micro and macro levels. Moreover, the prohibition on buying and selling shares acquired at preferential prices or for vouchers, further limits the chances of finding investors and of restructuring the privatized enterprises.

The Ministry of Finance is the second player with an interest in privatization. On one hand, the practice of subsidizing state enterprises represents a high fiscal burden and leads to macro-economic instability. For this reason the Ministry of Finance should be interested in conducting a fast paced and successful restructuring of enterprises. Moreover, the sale of enterprises for cash would provide additional revenues for the state (Ministry of Finance). On the other hand, implementing the law and paying out compensation for unused vouchers threatens the financial balance and implies decreases in other budgeted expenditures. Thus, the government is interested in seeing that the voucher privatization scheme be ended as soon as possible, and that no compensation takes place.

Voucher holders are the third group involved in the process of privatization. First of all, everybody has the legal right not to participate in privatization and to receive money for the unused vouchers. So, some voucher holders could expect cash compensation since they think that the government did not provide enough attractive property since in their view the government did not provide very promising shares in exchange for their vouchers. However, the confidence that vouchers could become a source of income for households was low from the very beginning of the voucher privatization process, as underscored by the fact that only 60% of all citizens made the effort to acquire vouchers.

4. The four scenarios

4.1. Scenario 1: Continuation of voucher privatization (maintaining the status quo)

Continuation of voucher privatization will preserve the inefficient privatization system. In other words, *none of the privatization goals will be achieved*. The Ministry of Finance will receive neither extra funds from the sale of enterprises, nor money from increased taxes. The privatized enterprises will face difficulties in seeking strategic investors; their financial condition will continue to deteriorate. Due to the poor financial condition in the real sector and the state coffers, additional benefits to the population will not be available and nobody will get dividends, social programs cannot be improved, and Belarusian goods will not become more competitive. A stock market is unlikely to be created as well, as a result of the poor financial situation. All this will be the price for relative social stability.

State as the main shareholder changes nothing in privatized enterprise's function. Moreover, state enterprise has more chances to get different kind of state support. This could dramatically decrease the number of enterprises, which want to be privatized in principle. Given that the executive and the top-management of the enterprises understand the disadvantages of this voucher privatization scenario, one would expect that more enterprises would be made not available for privatization for all voucher holders (not just for employees). In this way people would theoretically have a chance to use their vouchers, but it seems that all potentially profitable and attractive enterprises will be sold for money. Will this not undermine the respect and trust in privatization and in the authorities?

4.2. Scenario 2: Monetary compensation

The advantages are:

- Exact implementation of the present law and protection of property rights;
- An end to the inefficient voucher privatization scheme and as a result
- Private sector development;

- Maintenance of social stability as no one political player would be able to accuse authorities in neglecting of the law.

It is worth emphasizing that the economic price for maintaining social stability and of exactly implementing this - to some extent populist - law is too high under the present Belarusian conditions. As mentioned above, the Ministry of Finance would need BYR 804 bn (USD 392 m) to provide compensation to the owners of unused vouchers. Every voucher holder would get USD 30-120 (depending on the number of vouchers held). This amount is higher than that paid as dividends by the privatized enterprises (most of them have paid no dividends at all due to poor financial conditions). Hence, *those who refused to participate in privatization would find themselves in a better financial position than those who participated*, which could well start another wave of discussions on social justice and, on contrary, might undermine social stability and trust in market reforms.

4.3. Scenario 3: Creation of new investment funds to purchase for vouchers

The government could also create new investment funds (NIFs) whose shares could be exchanged for vouchers. The shares of the privatized enterprises could be randomly distributed among them, for example, 10 investment funds could own the shares of 5000 enterprises. This would eliminate the initial risks for the voucher owners and for the investment funds.

Three bodies would manage each fund: a Supervisory Board, a Board of Directors and a Management Company. Initially, the government would appoint members to hire the membership of the Supervisory Board on the basis of open competitions. The Supervisory Board would approve the Management Company, which would also be selected on a contest basis. The Management Company could be a private firm, a commercial bank, an investment fund managers, venture entrepreneurs or consultants - from Belarus or abroad.

The advantages of this scenario are:

- Compliance with the law (privatization will continue, vouchers can be exchanged for NIF shares);
- The Ministry of Finance won't need to find an additional USD 400 m;
- The possibility to purchase a controlling block of shares with the goal of later selling them to strategic investors, and to use well-known companies as advisors, will create conditions for active enterprise restructuring in Belarus.

Poland has the most successful experience with creating such funds and Belarus could use it in order to create such institutions in order to begin real processes of privatization and restructuring.

4.4. Scenario 4: Termination of voucher privatization and no compensation

The main drawback of a termination of the voucher privatization process on December 31, 2003 without monetary compensation is that it does not comply with the law. The voucher holders would likely feel that they were cheated. The state would again reinforce the people's low level of trust in the law by not implementing an existing law because it is too costly. Some politicians will certainly make this point in their coming political campaigns (2004 is the year of new parliamentary elections).

On the other hand, there is one big advantage. The termination of voucher privatization will remove the prohibition for trading shares and *will influence the development of the private sector*. Money privatization, sales of shares, and the search for strategic investors by enterprises will create implications for increasing efficiency and for the improvement in international competitiveness.

5. Policy recommendations

From the points of view of market reforms and the transformation of state ownership any form of privatization is better than none. The voucher privatization has not proven to be effective over the short run, giving cause for criticism. Having analyzed the experience of voucher privatization in other transition countries one could make the following conclusion: due to imperfections in the legislation and certain institutional factors the company managers who participated in the privatization took over in the majority of cases and redistributed the properties, instead

of working on long-term market restructuring. Yet, over the long term even voucher privatization is better than no privatization at all.

The continuation of the voucher privatization process (scenario 1)– though politically speaking the easiest solution – would impose real limits on restructuring the privatized enterprises (sale of shares). That is very inefficient for economy.

Government does not have money for cash compensation (scenario 2) even if it is the fairest solution. That is why we disagree with the parliament on the necessity of money compensation to the voucher holders. In any case, the attempts to find USD 400 m would touch practically every taxpayer through reduction in social programs, price increases for subsidized goods and services, growth of the internal and external debt, inflation growth etc.

Creating NIFs (scenario 3) looks better than continuation of current scheme of voucher privatization. But even leaving aside the skepticism of the people towards the emergence of one more institution like SIF (which was a negative experience), or the necessity for the Ministry of Finance to finance PR campaigns, and the time required for creating and promoting such organizations, this scenario has one main defect: It is not feasible in the current political climate of Belarus, as there is no mass privatization. Any attempts to copy the Polish experience will fail, since Belarusian funds would likely be limited in their rights. It will therefore not be the well-known international consulting and financial companies who will be the management companies, but Belarusian companies for reasons of economic and national security.

As we think only by terminating the voucher privatization scheme without compensation (scenario 4) would the private sector development in Belarus receive the strong incentive it needs. That is the most important thing Belarusian economy needs. Over the short term, the loss of value of the vouchers is a direct loss for their holders, but over the long term all groups will win: a) The government will see an increase in revenue as a result of more privatization, a decrease of expenditures targeted at supporting ineffective enterprises, a decrease of the tax burden, etc.; b) Enterprises will start real restructuring which will increase their profits; c) Voucher holders will benefit from a general improvement in the economic situation, including more competitive commodities and higher wages in the future.

Our proposal to terminate the voucher privatization scheme without compensation implies not honoring the compensation pledge to voucher holders. In our opinion politicians should admit that it has been a mistake to make unrealistic promises in the past. And they should explain that for the future welfare of the population (including most of the voucher holders) it is much better not to honor this unrealistic pledge and to take the right economic decision, than to honor the pledge and to take the wrong decision. Thus, government and parliament will be able to conduct a sound economic policy, without experiencing a significant lost in popular confidence.

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Minsk, August 2003